WISCONSIN DEPARTMENT OF COMMERCE

REVOLVING LOAN FUND ADMINISTRATOR'S GUIDE

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INTRODUCTION

In pursuing their economic goals and objectives, many Wisconsin communities have participated in the Wisconsin Community Development Block Grant Program for Economic Development (CDBG-ED). The CDBG-ED program provides local units of government financing that can be used to help businesses structure financial packages necessary to commence start-up operations or expand present operations. Businesses look to the CDBG-ED program for financing when it cannot meet all its financing needs through conventional means such as through local banks, the federal Small Business Administration, Farmers Home Administration programs and other capital resources such as venture capital and local economic development organizations.

CDBG-ED funds are made available to local units of government in the form of a grant. The local unit of government loans these funds to a local business. Specific financing terms vary, depending on the needs of the business and the criteria set forth by the community. The financing terms may include deferred payments, reduced interest, and acceptance of subordinated collateral positions. The loans are repaid directly to the community. It is these repayments of the CDBG-ED loan that are used to capitalize a community's local Revolving Loan Fund (RLF).

The amount of income that can be retained by a community from CDBG-ED loan repayments, to capitalize a RLF is dependent on the population of the community in accord with Wis. Admin. rule DOD 6.18 (4) (a), is shown below:

Population	Maximum retention (Cap)
1,000 and under	$100,000
1,001 - 1,999	$150,000
2,000 - 3,999	$250,000
4,000 - 9,999	$500,000
10,000 and over	$750,000

Regardless of the amount retained, once a community capitalizes a revolving loan fund with repaid CDBG-ED loan repayments, the community takes on a major "non-traditional" responsibility, functioning as a lender. The community re-lends the loan repayments to other local businesses in need of financing. These lending responsibilities are similar to those of commercial lenders and include loan marketing, application processing, credit analysis, lending decisions, loan closing and documentation, and loan servicing.

Administration of a loan made from a local RLF does differ in some respects from the administration of a conventional loan. The RLF dollars are public funds, and they may be supplemented with private financing from local banks. In using public funds, the RLF administrator must demonstrate for the taxpayers that their funds are being used for a public benefit. This benefit is typically measured in terms of retaining or creating employment opportunities, leveraging additional private investment in the community and expanding local tax base.

This Administrator's Guide is designed to help both the local elected official who is establishing a RLF for the first time and also the experienced RLF administrator who is interested in new ideas on procedures and policies. This guide, by design, is in a compact form that is informational and instructional, and can be used as a handbook in orienting newly elected officials and members of local economic development committees as to the opportunities and responsibilities that accompany a RLF program. This guide is not intended to be all inclusive of the responsibilities of administering public funds for lending purposes, but is expected to create an awareness of the scope of the responsibilities that come with establishing a RLF and to provide guidance on handling common situations.

The format of this document walks the new or experienced administrator through the process from capitalizing a revolving loan fund to the continuing administration of a RLF program. Throughout the Guide will be examples, suggestions, and sample forms for use at the local level. In the end, local administrators will need to take actions and develop policies and procedures that meet the community's specific needs and that are also within the parameters of the federal and state regulations that accompany the use of the CDBG-ED funds that capitalize the RLF. Local RLF administrators are encouraged to consult with their legal counsel when establishing and administering a RLF.

In addition to the use of this Guide, additional guidance materials and forms may be obtained from agencies or offices that provide similar services and information to their constituents. These agencies or offices may include local banks or state banking associations, local economic development corporations, other nearby and established RLF programs, and economic development professionals that specialize in business development. Local administrators may copy from this Guide any materials that meet their needs. However, this Guide is strictly what it is called, merely a Guide. Legal counsel should be sought whenever deemed necessary. Where practical, the community may also borrow from the commercial lending industry those practices, forms, and procedures that will help the community meet its accounting, legal, and fiscal responsibilities as it relates to safeguarding the RLF funds.

In addition to accountability to the taxpayers, the local RLF administrator must insure that the taxpayer receive the benefits expected. Those benefits being job retention or creation, the leveraging of additional private investment into the community, an expanded tax base, and any other public goals as outlined by the community's goals and objectives.

I. CREATING AND CAPITALIZING A RLF PROGRAM

A community RLF program can be capitalized solely with loan repayments from a CDBG-ED grant to the community or with funds from multiple public and private sources. The amount of CDBG-ED funds that can be used to capitalize a RLF in whole or in part is based upon the population of the community, as discussed in the Introduction. Prior to the receipt of repayments from a CDBG-ED loan, there are a number of steps that need to be taken by the community in establishing its RLF.

The first step is to adopt and put into place a RLF manual for the establishment and administration of the program. The community needs to develop RLF program goals and objectives in concert with its overall economic development goals and objectives. The commitment of the community to support and participate in loans to local businesses is guided by the economic development revolving loan fund manual designed within the guidelines of the Wisconsin CDBG-ED program and the local RLF Loan Review Board created to implement the RLF program.

When CDBG-ED funds are co-mingled with other funds, separate accounting for the CDBG-ED funds must be maintained to document compliance with applicable federal and state regulations. The additional sources of funds, that can complement funds in the community's RLF, include contributions from local banks, local operating budgets, and other state and federal economic development programs. In some instances, countywide RLFs are established using CDBG-ED funds from one or more communities within the county. The pooling of CDBG-ED funds from multiple sources is encouraged, but the accounting system for the county RLF must be designed to track the funds in the event the program is dissolved or a member of a countywide RLF withdraws.

II. RLF POLICIES AND PROCEDURES MANUAL

The local CDBG-ED RLF Manual should define the administration of the local program with general provisions addressing administrative practices, eligibility criteria, application procedures, loan processing, performance monitoring and loan servicing procedures. In the creation of a RLF program comes the need to establish a Loan Review Board. The Board will oversee the community's RLF activities and guide the administrator. An optimum loan review board should include representation of the local governing body, the local commercial banking community, the local development corporation, if one exists, the chamber of commerce, a business law attorney, the RLF administrator, members from the community, and the local clerk as secretary. However, the size of the Board must be manageable and therefore having members with broad expertise is desired. Drawing upon the wealth of local expertise, such as that of the commercial lender, attorney, and local officials, brings about the knowledge needed by a Board to carry out the community's RLF program effectively and efficiently. This is particular as it relates to meeting the community's development needs and at the same time in coordination and conformance with generally accepted commercial lending practices.

III. MARKETING THE RLF PROGRAM

To be effective in carrying out the goals and objectives of the community, there needs to be public awareness of the local RLF program. This is best accomplished through marketing the program. An effective marketing program will include developing materials that best describe the community's economic development goals and objectives and the availability of RLF monies. Supporting marketing materials can include a description of the program, its application procedures, contacts for additional information and other related information. Some communities use brochures and videos. In all cases, the information is simple, brief, and concise. This material is often distributed to County offices, Chambers of Commerce, local development corporations, banks, attorneys, public accountants, the local public library, and, most importantly, to local businesses to make them aware of this local and flexible financing source. Studies have shown that existing businesses are major contributors to local economic growth and the knowledge of additional financing options may be all that is needed to prompt a local business to expand its operations.

The RLF administrator should periodically make presentations on the program. These presentations may be in the form of brief breakfast seminars targeted to local bankers and businesses, appearances at a Rotary luncheon, or at other gatherings that include an audience that can use and will benefit from information on the RLF program.

IV. RECEIVING AND PROCESSING THE RLF APPLICATION

Once the RLF program is in place and is being marketed through a variety of channels, the next step is for the community to respond to inquiries received regarding the program and to meet with businesspersons interested in the program. These meetings provide the RLF administrator with the opportunity to learn more about an applicant's business plans and financing needs and also gives the businessperson the chance to become familiar with his/her responsibilities when using public dollars for private business development. The business' need for the financing needs to be reviewed as to how those needs and expected benefits fit the local RLF criteria and the community's program objectives. There are several steps to be followed before an application can be processed and passed along to the Loan Review Committee for review and action.

As stated above, a pre-application meeting should be arranged between RLF staff and the applicant to review and discuss the business financing need as well as the suitability of the project for RLF dollars. This meeting may either be at the RLF office or at the business, at the discretion of the RLF administrator and applicant. However, at some point in the application or review process, the RLF administrator should visit the business to observe operations and to develop a better feel for the prospective credit. On-site meetings with the applicant are very valuable. Things to observe during an on-site visit are cleanliness of the site, level of activity (i.e. Is shipping taking place? How many machines are up and running? Are storage facilities clean and dry to protect the inventory? Is there any hint of environmental contamination problems?), general attitudes or conduct of the employees, and management's organization, particularly as it relates to the business records and files. Wherever the meeting takes place, it is important to review carefully with the prospective applicant the criteria of the RLF program, including, eligible uses for funds, private match and job creation requirements, documentation requirements, the loan review and approval process, the contents of the loan agreement and reporting requirements.

The criteria, requirements, and standards as referenced above should be explained in the RLF program information and application materials. By making the information regarding standards and requirements available prior to the pre-application meeting, the prospective applicant becomes familiar with the community's goals and objectives in using public funds for a loan to the business. It is during the pre-application meeting that the RLF program administrator can explain in greater detail how the various criteria and requirements can be met effectively to the mutual benefit of the community and business.

Upon receipt of an application, the administrator should follow a standard check-in process to ensure completeness and readiness of the application for review. The program administrator should have a checklist in place to guide the checking in of an application. The checklist designed for use in your community should be tailored to the specific needs of your program.

V. CREDIT EVALUATION

Once the check-in of the application is conducted and the application is determined to be complete, the program administrator proceeds to the most crucial component of the application review process, that being the credit analysis or evaluation. The analysis is critical to determine the likelihood of the loan being fully repaid. It is at this point that all of the objective facts need to be available to make this determination. It is only through this diligence and review that your RLF will be able to survive to support the community's RLF objectives.

An administrator and staff who have been trained in credit analysis will effectively accomplish the credit evaluation process. Such training is periodically available through consulting firms, banking organizations, and also through classes offered by technical colleges and the University of Wisconsin campuses including UW-Extension. Many communities, when recruiting for a RLF administrator, require candidates to have prior commercial banking or other similar experiences.

In the evaluation of a loan application, the most traditional approach to credit decisions can be analyzed through the following:

<u>CHARACTER</u> - This is one of the most important ingredients in credit decisions. Does the business applicant have good character and reputation? This involves such things as being a community leader in a position of trust, lack of a criminal record, absence of judgments, good personal credit history, and most importantly, being experienced in the business and having demonstrated good management practices.

<u>CAPACITY</u> - Capacity is the ability of the individual to repay the loan out of income or profits. If there is no capacity to make the loan payments, the loan should not be made even if the loan is collateralized. Determining capacity requires knowledge of financial statement interpretation, both historical and projected. Only someone familiar with these statements should undertake this task, since there will need to be an analysis of whether there will be sufficient cash flow to service the debt. Projections are usually referred to in projecting cash flow and only a trained or experienced analyst who understands the pitfalls of relying solely on projections can estimate cash flow.

<u>CAPITAL</u> - The resources available to potential borrowers to meet their obligations is a major ingredient of lending. These resources should be in the business, however it is not uncommon to include personal capital as a source of repayment, particularly during the start up period for a new business or during seasonal fluctuation for seasonal business. Lenders in determining ability to repay a loan often consider spousal resources, such as income from another job.

<u>COLLATERAL</u> - While character, capacity, and capital are the most important ingredients in a credit decision, collateral plays a key role in providing a source of repayment should the business fail to make its required payments.

CONDITIONS - Any community that makes loans without consideration of the economy and conditions relative to the applicant's business may end up taking an unnecessary risk. Cyclical businesses in particular are difficult to finance due to the irregularity of cash flow. Cyclical businesses often are seasonal, and should the business depend on certain weather conditions, any adverse deviation from normal weather conditions could seriously jeopardize the businesses ability to service debt. Since cyclical businesses play an important role in many local communities, particularly those that are tourist orientated, caution should be exercised in not rejecting a loan applicant due to unpredictable receivables. Caution should be exercised in structuring a loan that recognizes the variables and therefore the terms and conditions of the loan are flexible for these situations.

VI. LOAN APPROVALS / DENIALS

If the application is approved, the administrator should set up a meeting with the applicant to further negotiate and arrive at an understanding of the terms of the loan and to review the covenants that will accompany the loan. Often times, it is wise to include the other lenders in the project at the meeting to ensure they understand the requirements associated with the public dollars. This meeting should also include a review of the draft loan agreement, contingencies that will need to be met (i.e. clear title, evidence of permits), the promissory note, collateral requirements for the loan, and the repayment (amortization) schedule.

If the loan is rejected, the administrator should contact the applicant stating the reasons for the denial as well as offering to follow up with a meeting to explore how the deficiencies of the application can be addressed, or what assistance may be available elsewhere. This contact should be followed up with a written letter confirming the discussion.

VII. CLOSING AND LOAN DOCUMENTATION

At the closing, the appropriate documents need to be in place before one can execute the loan document and advance the funds. A documentation checklist is a guide to help make sure that all of the documents are in place prior to the actual closing. The checklist sets forth a listing of documents appropriate for use in connection with loan closing. Safe practices may suggest the need for additional documentation not included on this checklist. Be sure to consult legal counsel to be certain that the forms and procedures noted on the checklist are appropriate for your transaction. Legal counsel used to assist RLF staff should be knowledgeable in business law and finance. In smaller communities, such expertise may not be available locally and therefore legal counsel may need to be obtained elsewhere. Legal expenses incurred are justifiable to ensure the proper documentation and closing of a loan. Furthermore, experienced legal counsel can advise the local RLF administrator and local officials of any lender liability issues particularly in regard to environmental contamination issues.

VIII. PERFORMANCE MONITORING AND SERVICING THE LOAN

Once the closing, the verification of recordings of closing and security documents are complete, and the funds have been distributed, there is an immediate need to set in place a performance monitoring schedule. This will ensure timely compliance with the loan covenants, such as the expenditures of other private funds, job creation, maintenance of insurance, obtaining of permits, the maintenance of records, and other provisions specific to the loan.

This may also include monitoring for the timely submission of financial reports from the business. This loan servicing will ensure that all loan covenant requirements are met to ensure the community's interest and funds in the project are protected.

Servicing a loan may be for as long as 5, 10, 15 or more years and involves maintaining loan security documentation, separate accounting records, initiating collection and possibly foreclosure actions if the obligations that were set out in the loan agreement are not met. There may also be imposition of penalties if the business fails to create the promised jobs or to make the additional private investment as specified in the loan agreement.

IX. PROBLEM LOANS AND COLLECTIONS

There are several common warning flags that may come up with a loan that suggests the presence of problems or conditions that will soon result in problems, and more specifically for purposes of discussion here, repayment problems. Simply responding to these warning flags in a timely manner can help save the loan or in an extreme situation, can help recover the maximum amount possible from the loan. The warning flags can also signal the need for a restructuring of the terms and conditions of the loan. RLF loans usually can afford to be patient and responding quickly to the warning flags may help prevent other lenders from pulling their financing. Whenever a warning flag is noted, there should be immediate communications with the business and other creditors. Regardless of collateral coverage, personal guarantee, and so forth, collection actions and foreclosures are costly and time consuming for all parties involved, including the employees whose jobs are at stake.

Following are some warning flags that merit any creditors' immediate attention:

- Overdrafts or a reduction in normal deposits and account average balances.
- Payroll withholding taxes unpaid.
- Lawsuits or garnishments against borrower.
- Information from borrower turns out to be inaccurate.
- A loss of interest or communications by borrower, his attorney or accountant.
- Attorney, accountant or related professionals being replaced or competent key personnel leaving debtor.
- Late furnishing of required necessary information.
- Late in making loan payments in RLF or other creditors.
- Late in making lease payments.
- Reluctant to furnish additional available collateral when requested to do so.
- Reluctance by owners and spouse to guarantee debts of "their" corporation or partnership.
- Reluctance of owners to subordinate loans made to business and to have such loans

placed on standby while the RLF loan is outstanding.

- Business owner, who has never borrowed personally, beginning to do so or entering into leases after being turned down for loan on same equipment.

- Increasing number of credit inquiries from other lenders. Questioning these inquirers can lead to information on the borrower.

- Negative community information on the personal conduct of borrower or officers.

- Heavy use of seasonal line of credit.

- Rapid expansion financed by short-term borrowing.

- Adverse trends in key financial ratios.

- Disappearance of collateral.

- Decreasing inventories or accounts receivable.

- Depreciation in possessory collateral.

- Declining economic conditions and the outlook for the debtor's industry.

X. DEFAULT

Under the best of circumstances, the loan will be repaid in accordance with its terms and conditions. However, there will be times when there may be repayment problems by the business. Responding to these quickly is imperative for all parties involved, since a quick response preserves options for a restructuring of the loan and the continued existence of the business. Although it was indicated that the RLF typically could be a patient lender, there may be situations where there is little choice other that to call the loan due and payable and to initiate appropriate foreclosures actions if necessary. If after liquidation of the business, there remains unpaid principal, it may be necessary to pursue the personal guarantee to collect any outstanding balances. The community needs to be prepared to take this action. Such actions are drastic and are extremely difficult, particularly when the individual may be a visible and active citizen in the community. The loan has created a business relationship via contract and therefore the community must protect its public investment in a project.

XI. CONCLUSION

This Revolving Loan Fund Handbook has been designed to proactively assist your community in the administration of your RLF. Although this Handbook can be modified to adapt to your community's specific goals and objectives, the material contained within has been found to be workable in many communities throughout the state and is consistent with applicable state and federal CDBG program requirements.

Additional technical assistance is available by contacting Department staff at the Department of Commerce, 201 West Washington Avenue, P.O. Box 7970, Madison, Wisconsin 53707, or call Mr. Dan Ramsey at 608 267-9383.